enable them to seek any necessary licenses. Under that approach, the ILEC would provide, on request, a list of known vendors of equipment and software and known licensing and right-to-use agreements that may be applicable to the network element being purchased. The CLEC would then present evidence to the ILEC that it had obtained licenses or right-to-use agreements necessary to use the unbundled network elements.

MCI argues that the potential burden on a CLEC is substantial, in light of the number of contracts identified by SWBT in response to a request from AT&T. See Petition at 5. But SWBT's list was intended to be comprehensive, covering all known licenses associated with network elements, rather than being limited to a particular CLEC's particular purchase of unbundled network elements. [3] Moreover, the list included, for example, over twenty-five contracts with Lucent Technologies, as to which AT&T would have no need for additional licenses, and other contracts as to which AT&T may also already have been licensed or have had a prior vendor relationship. MCI (or any other CLEC) might have no need for licenses from any or all of the listed contracts, either because of its particular network configuration or because it has already negotiated a license from the particular vendor. In practice, and in response to a particular CLEC's request, the list of potential license agreements might be substantially smaller.

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[3] The list has subsequently been updated as additional contracts have been identified.

The question of the potential burden on a CLEC cannot be viewed in the abstract. Nor can the Commission hope to resolve intellectual property issues raised by any particular contract or contracts. Rather, it should simply establish a framework whereby the necessary information is provided to the CLEC in the context of a particular request. The responsibility for obtaining licenses, if any are necessary, must rest with the CLEC whose service offerings raise the intellectual property question. This approach will place the burden upon the entity which will benefit from the use of intellectual property of third parties.

B. ILECs Cannot Acquire the Necessary Intellectual Property Rights on Behalf of Competing LECs.

MCI's proposal that ILECs should be made responsible for obtaining intellectual property rights on behalf of CLECs is untenable. See Petition at 7-10. The problem begins with the fact that the rights are owned by third parties. MCI's proposal might be interpreted as requiring ILECs either to negotiate on behalf of CLECs -- in effect becoming their agents vis a vis the owners-- or to acquire rights and then license them to CLECs -- in effect becoming their licensors. Casting ILECs in either role would present insurmountable difficulties.

First, ILECs could not serve as CLECs' negotiating agents. An agent must have knowledge about the principal's needs and business plans in order to negotiate effectively on its behalf. But in this context, it would seem unrealistic to expect a CLEC to provide such necessary information -- e.g., about future service offerings, service territory, projected volume of use, or configuration of CLEC-supplied network elements -- to the ILEC, its direct competitor. See Milgrim Aff. at ¶ 27.

There is a fundamental incompatibility between the relationship among ILECs and CLECs as competitors and the relationship of principal and agent. Under agency law, an agent is a fiduciary that generally has a duty of loyalty to its principal, a duty not to compete with its principal, a duty not to disclose its principal's confidential information, and a duty not to act on behalf of other parties whose interests conflict with its principal's. See Restatement (Second) of Agency §§ 387, 393-395 (1958).[4] But here, the ILEC would be negotiating on behalf not only of a single CLEC competitor, but on behalf of numerous CLECs, which compete not only with the ILEC but with each other. Even if all CLECs saw fit to provide the ILEC with the necessary information for an effective representation, the conflicting cross-related duties imposed by the ILEC's incompatible roles would create an impossible competitive situation.

Even apart from these legal and competitive problems, however, it seems unlikely as a practical matter that the ILEC-as-negotiating-agent scheme suggested by MCI could possibly function successfully. There are serious questions as to whether active and aggressive competitors such as MCI, having

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[4] An agent also has the right to protect its own superior interests, id. at § 418, and the general duties can be modified by agreement.

forced the ILECs into such a role, would not use the process to delay or impede the ILECs' own competitive plans. For example, delays in providing necessary information or in responding to or approving proposed license agreements would stymie the operation of the statutory open competition scheme.

Moreover, a CLEC might well later make claims against an ILEC that had negotiated a license agreement on its behalf, on the ground that the agreement was too narrow, that it was too broad and hence too expensive, or that it was not as favorable as an agreement negotiated on behalf of another CLEC. The ILEC would only negotiate on the basis that the entire license fee would be passed through to the CLEC, but the CLEC would have no control of the price being negotiated on its behalf. It may be for such reasons as these that Mr. Milgrim, who has many years of experience with licensing agreements, has not seen similar arrangements. Milgrim Aff. at ¶ 27.

Nor is it possible to require ILECs somehow to acquire all necessary intellectual property rights from vendors so that they can provide them to CLECs by sublicense. First, the policy basis for requiring the provision of access to unbundled network elements is to encourage facilities-based competition by new entrants in the local exchange market as well as flexibility in the network configurations and local exchange services they will offer. Thus, it is anticipated that CLECs will develop their own network facilities for use in conjunction with ILEC network elements, or at least develop their own configurations of network elements in order to offer competing services.

Given the expectation that CLECs will develop innovative network designs and services, it would simply be impossible for ILECs to seek all rights in advance that would be necessary for them to be able to sublicense all possible uses and configurations of unbundled network elements by all possible CLECs.[5] ILECs cannot know the scope of all such potential uses and configurations, both because the market is still developing and because CLECs cannot be expected to disclose their future competitive plans to ILECs.

ILECs thus cannot become licensors of the intellectual property rights of third parties. Unlike the ILECs, equipment and software vendors are in the best position to identify and license directly to CLECs any intellectual property rights that will be required for the CLECs to offer services in accordance with their business plan. Because they have designed or acquired the equipment or software for the purpose of marketing it for use by others, they typically are aware of the scope of pre-existing patent rights, have conducted appropriate intellectual property searches, and warrant the intellectual property status of their products. By contrast, an ILEC that purchased equipment from such a vendor would be in no position to be able to evaluate or even to identify all intellectual property rights implicated by a CLEC's proposed use of the equipment.

[5] Moreover, from an economic perspective, the licensing of all potential uses in advance, even if it were possible to do so, would be expensive and wasteful. By contrast, licensing by each CLEC to cover the specific uses in which it proposes to engage would not involve the purchase of unnecessary rights.

Indeed, the grants and warranties that equipment vendors provide are often limited to use of the equipment in the particular configuration for which the ILEC has purchased it. See Milgrim Aff. at ¶ 19 and Appendix C. As the contract language indicates, the use of the equipment in other combinations will mean that the vendor no longer warrants that other third parties' patent rights would not be infringed. If a vendor were to negotiate directly with a CLEC interested in using its equipment, the vendor would be able to obtain any necessary confidential information about how the CLEC intended to use the equipment, and would identify and impose any necessary limitations in light of its knowledge of the intellectual property rights involved. The CLEC would be able to evaluate the operational and/or financial cost of any such limitations and decide whether to accept them, or to seek alternative arrangements or modify other aspects of its business plan to accommodate them.

In the absence of information about every CLEC's plans and alternative plans, as well as information about the scope of the vendor's original intellectual property rights, as a practical matter an ILEC cannot acquire the necessary rights from the vendor for later sublicensing, or even to identify and sublicense the rights necessary for use of the network element in the particular configuration contemplated by the CLEC. Depending on the CLEC's own network equipment and system, the use of the ILEC's unbundled network element in that configuration might even implicate the intellectual property rights of <u>fourth</u> parties (i.e., patent holders, including the CLEC's vendors, other than the ILEC's vendor or the ILEC), which could not be known to or anticipated by the ILEC in the absence of information about the CLEC's business plan. There would also be difficulties in such a system because of potential territorial restrictions. MCI, for example, might prefer a license without any territorial restrictions in order to be able to use certain equipment in providing local exchange services in a variety of locations. The ILEC, by contrast, would otherwise have no reason to have obtained such rights.

Moreover, it is important that there be direct privity of contract between the CLEC and the owner of the intellectual property. Manufacturers impose nondisclosure obligations and other restrictions through contract that they cannot rely on others to enforce, but which protect their intellectual property. By the same token, a CLEC user of an unbundled network element cannot rely on an ILEC to warrant equipment or software the ILEC did not produce.

A similar problem is that, under some vendor contracts, the disclosure of or provision of access by third parties to confidential information may void the vendor's warranties. Thus, by providing access to unbundled network elements for CLECs that do not contract directly with the vendor for authority to use the confidential information, an ILEC could lose important remedies for defects in or failure of its network equipment. This surely cannot be an appropriate outcome.

In short, the CLECs themselves are the only parties who have the knowledge and economic incentives to negotiate appropriate intellectual property licenses for their own use of unbundled network elements.

C. The Telecommunications Act Of 1996 Does Not Authorize Or Require the Result MCI Seeks.

MCI argues that Section 251(c)(3) of the Telecommunications Act of 1996 requires that an ILEC must obtain additional intellectual property rights on behalf of a CLEC. Petition at 8. But requiring CLECs to obtain intellectual property rights necessitated by their own use of unbundled network elements in no way violates the requirement that access to network elements be provided on terms that are just, reasonable, and non-discriminatory. The cost, if any, of additional intellectual property licenses or rights to use agreements are necessitated by the individual attributes of the particular CLEC, and are within its control. ILECs cannot be required by Section 251(c)(3) to acquire rights from third parties that they do not already have, in order to provide them to CLECs.

Indeed, the Commission has neither the authority to interfere with, nor the expertise to determine, intellectual property rights of third parties, or to resolve the myriad issues that may arise in the particular circumstances presented by a particular CLEC proposal. The resolution of such issues should be dealt with outside the Commission's processes, in accordance with conventional intellectual property principles, by requiring CLECs to obtain any third party rights they need directly from those third parties.

MCI also argues, without support, that potential competitors do not possess the same leverage as ILECs in negotiating with vendors for intellectual property licenses. Petition at 8. To the contrary, potential competitors such as MCI are large and sophisticated carriers that already have experience, or even prior license agreements, with the principal vendors from which the ILECs have obtained equipment and software. Moreover, when, like MCI, they are potentially negotiating for national rights, as opposed to rights within a particular state or region, they can be expected to have greater leverage with the vendors than any ILEC.

CONCLUSION

Intellectual property rights are implicated when CLECs use certain unbundled network elements as part of their provision of local exchange services. The Commission should require CLECs to obtain appropriate licenses or right-to-use agreements, to the extent necessary, directly from third party intellectual property owners. A system whereby the ILEC identifies the potentially necessary licenses of which it is aware in response to the CLEC's request would provide a workable framework within which individual intellectual property issues can be most appropriately resolved.

Respectfully submitted,

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April 15, 1997

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Petition of MCI for Declaratory Ruling	)))))	CC Docket-96-98 File No. CCB POL 97-4

AFFIDAVIT

Qualifications

1. I am an attorney at law, practicing in New York City. I have been a member of the Bar of the State of New York since December 1961 and have practiced in New York continuously since then except for the period of June 1962 through August 1965, during which period I was a student at the University of Paris School of Law for an academic year and thereafter practiced as a <u>conseiller juridique</u> in the Paris office of a large U.S. international law firm.

2. In addition to being admitted to the Bar of the State of New York, I am admitted to the Bars of the United States Supreme Court and numerous federal district and appellate courts including the United States Courts of Appeals for the Federal Circuit, the Second Circuit, the Third Circuit, the Ninth Circuit and the Eleventh Circuit.

3. I am a partner in the New York City Office of the law firm of Paul, Hastings, Janofsky & Walker LLP. This firm also has offices in Atlanta, Los Angeles, Orange

County, San Francisco, Stamford, Tokyo and Washington, D.C. My Curriculum Vitae is attached as Appendix A.

4. Since 1962, in practice I have been engaged in a wide array of intellectual property law. I have participated in the drafting, negotiation, review and analysis of numerous domestic and transnational licenses and other transfers of technology and intellectual property concerning a broad range of industry. This includes the automotive, chemical and petrochemical, computer hardware and software, pharmaceutical, telecommunication and transportation industries. I also have served as an advocate and as an expert witness in numerous disputes relating to trade secrets and licensing, including licensing in the telecommunications field. Since 1976 I have been an adjunct professor of law at N.Y.U. School of Law. My courses have been directed to intellectual property and licensing. I am a frequent lecturer on intellectual property and licensing at national, state and city bar associations, patent and other intellectual property associations and law schools.

5. In 1968, Matthew Bender published my treatise on the law of Trade Secrets. Over the intervening 29 years, it has been revised 55 times (currently, it is revised three times per year) and is now a four-volume work, titled

Milgrim on Trade Secrets ("**Trade Secrets**"). That work, which, in addition to addressing all aspects of trade secret law, also covers in considerable detail patent and copyright law, id. §§ 9.02-9.03, and chap. 10 (antitrust aspects of intellectual property) is widely used by practitioners and has been cited for key trade secret propositions by numerous federal and state courts, including the Supreme Court. See, e.g., Thomas v. Union Carbide Agr. Prods. Co., 473 U.S. 568, 584, 105 S. Ct. 3325, 3335 (1985); Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1002, 1004 n.9, 104 S. Ct. 2862, 2872, 2873 n.9 (1984).

6. In 1990, Matthew Bender published my treatise on patent, trade secret, copyright and trademark licensing, titled *Milgrim on Licensing* ("**Licensing**"). This work is widely subscribed and has been supplemented annually (and, beginning this year, is to be supplemented twice annually). Later this year it will become a four-volume work.

General Aspects of Licensing

7. Telecommunications equipment and operation is the subject of each of the principal forms of intellectual property: patents, copyrights, trade secrets and trademarks. These forms of protection are separate, distinct and complementary. Patent protection affords

exclusive exclusionary rights for inventions, which can cover telecommunications equipment, systems and methods, and can protect computer software in conjunction with equipment to claim the apparatus or a method. Copyright is exclusive but nonexclusionary, so that copying, preparation of derivative works and distribution are actionable if the defendant "copied" but not if the defendant actually independently developed an identical or similar work. Trade secret protection is neither exclusive nor exclusionary, but rather prevents unauthorized use or disclosure by those standing in a contractual or confidential relationship with the trade secret owner and third parties who use improper means to acquire the trade secret from the owner. Trademarks and service marks serve to identify the origin of goods and services but do not protect the goods or services from ordinary competition. Trade Secrets § 9.06 (attached for convenience as Appendix B) presents, in chart form, a detailed comparison of these forms of intellectual property protection.

8. The licensing of these intellectual property rights is an integral part of our economy and is widely prevalent in the telecommunications and other industries. This affidavit concentrates on copyright and software licensing because that is the area of licensing most broadly pertinent to the issues that MCI's filings raise. However,

as this affidavit observes (¶16), there are significant patent issues involved as well.

9. The licensing of computer software ("**software**"), a fundamental form of technology in the telecommunications industry, is a principal way in which that technology is transferred. Outright sale of the copyright and other intellectual property within commercial software is relatively infrequent.

10. Software is protected under both copyright and trade secret.[1] Copyright covers the form of program's expression; trade secret protection, the program's unpublished informational content. Software can enjoy patent protection too. See the Patent and Trademark Office's Examination *Guidelines for Computer-Related Invention* (Feb. 1996), reproduced at Licensing App. 2D.

11. Licensors of commercial software usually distribute it in object code form. Such licensors usually do not provide the software in source code form because the source code reveals trade secrets. For that reason,

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1 As to copyright coverage of software, see Licensing § 5.10, 5.19, and as to trade secret coverage, see Trade Secrets §§ 1.06[6]-1.06[7].

A series of important cases recognize the dual copyright and trade secret protection of software. See Licensing § 5.30.

software licensors which provide only object code often contractually prohibit disassembly and other reverse-engineering methods that permit a party with access to object code to recreate or approximate the source code. In instances where software licensors do provide source code, usually they rigorously restrict unauthorized use or disclosure. When a software licensee is entrusted with source code (which occurs when, in order to operate and maintain the licensed software, the licensee must either maintain it or modify it to operate in a way that serves the licensee's current and future activities), it is therefore almost invariably subject to restrictions on (a) use by the licensee and (b) disclosure to third parties. When, as occurs in many software licensing situations, a software licensee is entrusted with the technical documentation needed to operate, modify and/or maintain the licensed software, that documentation is often designated as confidential and subject to the license's limitations on use and disclosure.

12. The operative provisions of software license agreements, as is the case of intellectual property licensing in general (see Licensing § 15.00), are varied. While software license agreements have many similarities, they can also vary in text and in rights granted as well as duties imposed. In part that is so because, often, the

terms of a license reflect finely sculpted transfers of specific rights.

13. In commercial software license settings, negotiations set the stage for the terms of the license. As a general matter, prospective licensors desire to restrict the scope of a license, and prospective licensees desire a broad grant of rights. Thus, in the abstract, a licensor often prefers the license to be nonexclusive, personal to the licensee, for the licensee's own business use for a narrowly defined activity, for a limited duration and for a restricted territory. A common limitation in commercial software licensing limits the licensee to use of the licensed software for the licensee's own business, so that the licensee cannot use the licensed software to "service" the business of others. The reason for a licensor to impose a limitation restricting use for the licensee's own business is to prevent the licensee from "competing" with the licensor. Similarly, if a software licensor makes underlying source code available, the licensor imposes careful restrictions on the licensee's use and disclosure of it, typically limiting access to it to only those employees or agents of the licensee who have a need for it, say to install, modify or maintain it. Such narrow, protected disclosure of the trade secret content of licensed matter is the exercise of the essence of the trade secret owner'

rights. See Trade Secrets § 2.01 at 2-2: "Quite simply, [the property right in a trade secret] is the right of the owner of the trade secret to **use and disclose** it to others subject to restrictions on their use and disclosure." (Emphasis in original.)

14. By contrast, a licensee often wants exclusive rights and unrestricted scope of use and irrevocable rights. Nonetheless, software licensees, as is the case for most trade secret licensees, routinely accept the confidentiality restrictions imposed by licensors. In commercial software licenses, particularly where the *licensor* develops or customizes software for the licensee's particular needs, the *licensee* supplies confidential information to the licensor, which accepts confidentiality duties.

15. Ultimately, the licensing arrangement that is achieved reflects the primordial fact that the licensor is not required to license, Licensing §§ 8.52-8.53, and that the licensee can elect to refrain from using that licensor's intellectual property through the use of functionally equivalent matter. The "package" of rights and duties ultimately negotiated in the final license is thus the result of (a) rights a willing licensor has to offer (if, for example, other licenses have been or are to be granted, the licensor cannot offer exclusivity) and (b) what a

willing licensee wants from among such rights, what that licensee is prepared to pay for those rights and what ancillary obligations the licensee will accept (e.g., for the licensor's on-going support, debugging and software maintenance services). The "price" of the license will be a function of several things, including the breadth of the rights licensed, the level of licensor software support services, and then-prevailing market conditions.

16. The terms that are ultimately negotiated in a software license define the licensee's entitlements and therefore have considerable potential consequence. Often a software licensee makes a substantial investment in hardware and selects or modifies other software to accommodate specific licensed programs. Because of such software-hardware and software-software interconnections and intense investment to implement and complement licensed software, a licensee must avoid exceeding the rights the license affords to it because to do so would be a breach of the terms of the license. A breach could cause (a) termination which, among other things (b) involves (i) the potential for serious business disruption and (ii) the risk of loss of not only the residual value of any lump sum royalty paid (a typical form of payment for commercial software, which thus differs from "typical" patent or other copyright licenses that call for running royalty based on sales or use), and (iii) the

value of associated hardware and software. In addition to breach-of-contract exposure, including loss of license, if a software licensee, without authorization, purported to extend rights in that software to a third party, that third party would under both patent and copyright analysis be an infringer and the licensee, a contributory infringer. (Many of the license agreements that I have reviewed for the preparation of this affidavit expressly negate the grant of any patent license by the software licensor; the licensee may have an implied patent license by reason of purchase of equipment from the software licensor but that implied license would not necessarily run in favor of uses of the software that MCI might make, such as operation on equipment not procured from the software licensor.)

17. I have reviewed over 45 licenses that SBC Communications, Inc. ("**SBC**") has supplied, including about 35 in which Southwestern Bell Telephone Company ("**SWBT**") is the licensee and about ten such licenses in which Pacific Bell or Nevada Bell ("**Pacific**") is the licensee (I will generally use "SBC" to refer to both SWBT and Pacific). These agreements are primarily software licenses. It is my understanding that the licensed software is in use in the operation, and can be accessed by the operator, of the SBC network facilities that MCI petitions to use under sections 251 and 253 of the Communication Act of 1996 (the "**1996**

Act"). The software licenses that we have reviewed between SWBT or Pacific and various third parties, including major software developers, are illustrative of the wide variety of licenses in use in local network facilities. In this affidavit, in the interests of brevity, I have therefore sought to address functional license provisions rather than quote specific texts. I attach, as Appendix C, a chart that references and summarizes in detail the pertinent provisions upon which my analysis relies. However, the chart identifies each of the licenses reviewed by item number, not by identity of the licensor, to respect the confidential character of the identity of the licensor and terms of agreements between SBC and such licensor.

Matters Considered

18. Initially, I describe the principal types of provisions that would preclude SBC from permitting MCI to use SBC-owned or leased equipment in which third-party software licensed to SBC is resident. (For completeness I note that, although my observations focus upon software, the licenses I have reviewed are not limited to software.) Then my opinion addresses both the principal contentions that MCI advances to support access to SBC's hardware despite the fact that use of that hardware involves use of or access to restricted, third-party owned software, and MCI's stated

concerns of the inconvenience and costs it anticipates if MCI were itself required to seek direct licenses.

Principal Restrictions on Software Licensed to SBC

19. Most of the software licenses to SBC are nonexclusive and many of the license agreements have grants that are expressly **personal** and **nontransferable**. In several instances, the license grant restricts use of the software licensed to SBC and its affiliates for its and their internal use (i.e., to operate its own business). In other instances the license grant is to SBC and its affiliates, and a fair reading is that the parties intended, in these personal and nontransferable grants, that the authorized scope of the license grant is to SBC and its affiliates for their use in operating their own business. And, many of the license agreements are expressly nonassignable and, in this context, subcontracting is often expressly prohibited. In some instances the software license is, by its terms, merely site- or CPU-specific, leaving unexpressed a restriction of use limited to the licensee's business. (In a distinct, small minority of instances, the license expressly authorizes the broadest use of the licensed software, i.e., for any lawful purpose, but even in that context there are provisions prohibiting assignment and subcontracting.) Any use or handling of the software in a manner that is

prohibited (which is the very thing implicated by MCI's request), and likely that is simply beyond use or handling authorized in the agreement, would be a fundamental, material breach of the licensor's intellectual property rights.

20. In addition to the common restriction of the grant of license for use restricted to SBC and its affiliates' internal use, most of the software license agreements impose "confidentiality" restrictions on the licensor's software. Namely, the licensee agrees either not to disassemble furnished object code or, where it does receive source code, to limit access to the source code to its employees and agents (such as persons assisting in software installation) and not to disclose it to third parties (except as needed to practice the license and modify or maintain the licensed software). Where access to source code is given to SBC, the confidentiality strictures are designed to prohibit any access by any third parties not expressly authorized therefor. These restrictions on use and disclosure, which reflect the exercise of the licensor's fundamental trade secret rights in the software, are the rule, not the exception, in software licensing.

21. If, to render its services to its customers on SBC's network facilities, MCI were to access licensed

object code, confidential source code or documentation for the software, that access alone would violate the licensor's intellectual property rights. MCI's employees and agents are not under SBC's supervision and control or subject to duties of confidentiality to SBC's licensors. Accordingly, permitting such access to software or documentation that is licensed to SBC subject to confidentiality restrictions would be a fundamental breach of intellectual property rights and licenses.

22. In considering MCI's contentions regarding access, the FCC is presented with the prospect not only of impairment of SBC's contractual entitlements, but also the impairment of contractual **and** property rights of third parties, namely SBC's licensors. Most of those software licensors are not, I am advised, regulated telecommunications enterprises. I believe that were the FCC to so proceed, that would pose profound Fifth Amendment taking and due process issues. See, e.g., Ruckelshaus v. Monsanto Co., supra (if a state characterizes interests in a trade secret as property, for purposes of any Fifth Amendment "Taking" analysis, it *is* property).[2]

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2 Virtually every state recognizes the trade secret owner's right to use and disclose subject to further restrictions on use and disclosure as a property right. Trade Secrets § 2.01[2] n.21. Indeed, the property rights in a trade secret are reflected in the federal statutory schemes. Thus, a trade secret is property (a) subject to (continued...)